

SENATE RECORD VOTE ANALYSIS

104th Congress
1st Session

Vote No. 284

June 26, 1995, 6:11 p.m.
Page S-9073 Temp. Record

PRIVATE SECURITIES LITIGATION/Greater Liability for Recklessness

SUBJECT: Private Securities Litigation Reform Act of 1995 . . . S. 240. Sarbanes amendment No. 1472.

ACTION: AMENDMENT REJECTED, 29-65

SYNOPSIS: As reported with an amendment in the nature of a substitute, S. 240, the Private Securities Litigation Reform Act, will enact changes to current private securities litigation practices in order to discourage unjust suits and to provide better information and protection from fraud for investors.

The Sarbanes amendment would amend the liability section for securities fraud. Under current securities law, a defendant who is guilty of intentional or knowing fraud, or of reckless conduct related to such fraud, may be sued. Actions are typically brought under the catchall fraud provision contained in Section 10(b) of the Securities Exchange Act and the Securities and Exchange Commission (SEC) Rule 10b-5. Congress never expressly provided for private rights of action when it enacted Section 10(b). The standards for finding recklessness, as a result, were developed by the courts and vary from court to court and case to case. All defendants in a securities litigation case are jointly and severally liable, meaning that if the amount that one defendant is liable for is not recoverable from that defendant, then it may be recovered from other defendants. Thus, if a defendant who is found to be 1 percent responsible for securities fraud is the only defendant from whom recovery is possible, that defendant may be ordered to pay 100 percent of the award. The bill substitute will change current law by limiting joint liability for defendants who are found to be culpable due to recklessness, rather than through knowingly committing fraud. Such defendants will retain joint and several liability for awards to plaintiffs who have net worths of less than \$200,000 and who have lost more than 10 percent of their net worths, but for awards to other plaintiffs their joint liability will only apply to the extent that recovery is not possible from those guilty of knowingly committing fraud, and will be limited to no more than 50 percent of their proportionate liability. The Sarbanes amendment would make two changes to the bill substitute's changes. First, it would eliminate the requirement that an investor with a net worth of less than \$200,000 must have lost at least 10 percent of his or her net worth before a reckless defendant would be held jointly liable. Second, it would increase the amount for which a reckless defendant would be held jointly liable for awards to plaintiffs with net worths over \$200,000 to 100 percent (instead of 50 percent) of the amount of that defendant's proportional liability.

(See other side)

YEAS (29)		NAYS (65)		NOT VOTING (5)	
Republicans (6 or 12%)	Democrats (23 or 55%)	Republicans (46 or 88%)	Democrats (19 or 45%)	Republicans (1)	Democrats (4)
Cohen	Akaka	Abraham	Helms	Baucus	
Jeffords	Biden	Ashcroft	Hutchison	Bingaman	
McCain	Boxer	Bennett	Inhofe	Bumpers	
Shelby	Bradley	Brown	Kassebaum	Byrd	
Snowe	Breaux	Burns	Kempthorne	Dodd	
Thompson	Bryan	Campbell	Kyl	Exon	
	Conrad	Chafee	Lott	Feinstein	
	Daschle	Coats	Lugar	Ford	
	Dorgan	Cochran	Mack	Glenn	
	Feingold	Coverdell	McConnell	Johnston	
	Graham	Craig	Murkowski	Kerry	
	Harkin	D'Amato	Nickles	Kohl	
	Heflin	DeWine	Packwood	Lieberman	
	Hollings	Dole	Pressler	Mikulski	
	Inouye	Domenici	Roth	Murray	
	Kennedy	Faircloth	Santorum	Nunn	
	Kerrey	Frist	Simpson	Pryor	
	Lautenberg	Gorton	Smith	Reid	
	Leahy	Grams	Specter	Robb	
	Levin	Grassley	Stevens		
	Rockefeller	Gregg	Thomas		
	Sarbanes	Hatch	Thurmond		
	Wellstone	Hatfield	Warner		
				VOTING PRESENT(1) Bond	
				EXPLANATION OF ABSENCE: 1—Official Buisiness 2—Necessarily Absent 3—Illness 4—Other	
				SYMBOLS: AY—Announced Yea AN—Announced Nay PY—Paired Yea PN—Paired Nay	

Those favoring the amendment contended:

The Senate has already rejected a broad reform of the bill substitute's proposed severe limitation on joint liability (see vote No. 282). This amendment, therefore, suggests a much more modest reform. First, the amendment would strike the requirement that people of modest means who have been defrauded must have lost at least 10 percent of their net worth before they have any right to a full recovery. The net worth limitation of \$200,000 would be retained. Frankly, we think this limit is too low, because many elderly people, particularly those who have paid off their home mortgages, have accumulated net worths in excess of \$200,000 over their lifetimes. Nevertheless, we have accepted \$200,000 as the cutoff point. However, requiring people to lose 10 percent of their net worths before they can recover money lost due to securities fraud is extreme. Assume, for example, that an elderly couple living on Social Security checks has a net worth of \$150,000, with \$110,000 of that worth from their home, \$20,000 from a wedding ring and other jewelry, and the remainder from other assets. If such a couple were defrauded of \$14,000, the party mostly guilty of that fraud fled the country, and the only other defendant left to collect from was found guilty of recklessness, they could not recover the full \$14,000. Instead, they could only collect the proportional amount the reckless defendant was responsible for, plus 50 percent. If that defendant was thus assigned 1 percent of the liability, this defrauded elderly couple would only collect \$225. If, however, they lost 10 percent of their net worth, or \$15,000, they could collect the full \$15,000 from this reckless defendant. We think this result is unfair. In either case, people of more limited means should be able to collect fully from any defendant. We therefore support the Sarbanes amendment's striking of the 10-percent loss requirement.

The other element of the Sarbanes amendment would increase the maximum additional joint liability for a reckless defendant to 100 percent of that defendant's proportional liability. Thus, if a reckless defendant's proportional liability were \$100,000, and if other defendant's could not be collected from for their shares of the liability, the reckless defendant could be ordered to pay \$200,000. We think this increase is fairer to plaintiffs than requiring reckless defendants to pay only 50 percent more.

The Sarbanes amendment makes two modest, sensible changes to the extreme limits on joint liability that are in the bill substitute. We would rather strike the joint liability section in its entirety, but we realize we do not have the votes. Hopefully, though, a majority of Senators will support this more modest effort.

Those opposing the amendment contended:

Every law has to draw a line. For thefts, stealing an object worth \$100 may be classified as a felony, and land one in jail for up to 10 years. Stealing an object worth \$99, though, may be a misdemeanor, with a maximum \$50 fine. Noting the discrepancy, there will always be someone who suggests moving the line, whether up or down. The Sarbanes amendment suggests doing away with one line and nudging another. First, it posits that any level of loss for a small investor should be fully recoverable from a reckless defendant. Frankly, we disagree. Under the Sarbanes amendment, thousands of small investors who lost \$500 each to a con artist who disappeared could go after a bank that failed to detect the scam, and force the bank to pay them in full. This amendment does away with the balance that is in the substitute amendment. In the substitute, if a small investor loses a substantial portion of his or her net worth, then the above bank could be forced to cover the loss, even if it had not knowingly engaged in fraud. In such a case, the unfairness of making the bank pay is less than the unfairness of making a small investor suffer a substantial loss. The substitute, with a 10-percent loss requirement, draws a line on the balance of harm. An investor who loses \$500 has not suffered a substantial degree of harm, but a peripheral, reckless defendant that has as little as 1 percent of the blame may end up with an enormous degree of harm if it is forced to pay thousands of such small investors. We support the 10-percent limit as a reasonable line to draw between the interests of investors and defendants found guilty of recklessness.

The other change in the Sarbanes amendment is equally unsupportable. Under the substitute amendment to the bill, large, sophisticated investors will be able to recover a maximum of 50 percent more from reckless defendants of the amount for which those defendants are severally liable. The Sarbanes amendment would increase this amount to 100 percent; in other words, companies which are only marginally involved in these suits could be made to pay 200 percent of the amount for which they are found liable, instead of 150 percent. The stated rationale of the amendment's sponsors is simply that they want to increase the amount for which reckless defendants are liable, and they are hopeful that a few Senators who voted against the earlier Shelby amendment would be supportive of this more modest increase. We are not. The increase is just a totally arbitrary adjustment of the line.

In our estimation, the limits on joint liability already offer a fair compromise between those Senators who wish to do away with joint liability for reckless defendants entirely, and those Senators who are happy with the current system. We oppose any efforts to tinker with this compromise, and thus oppose the Sarbanes amendment.